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Report Highlights:

Mexico's fluid milk production, along with NFDM, cheese, and butter, is expected to rise only marginally in 2008. Imports of NFDM are expected to continue to increase, driven by favorable prices and the elimination of the TRQ on NFDM under NAFTA. Consumption of dairy products in Mexico is expected to continue to grow moderately in 2008, in line with population and income growth.

Includes PSD Changes: Yes
Includes Trade Matrix: No
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SECTION I. SITUATION AND OUTLOOK

After several years of impressive growth, the Mexican dairy industry is experiencing a leveling off in production. This stall is primarily due to higher feed costs and infrastructure constraints. Imports of NFDM are expected to increase by nearly 15% to 140,000 MT due to tighter availability of domestically produced milk, the elimination of the NAFTA TRQ on NFDM, and favorable international prices. Though there is a Congressional mandate to distribute more domestically produced milk through social programs, pricing pressure and tighter supplies continues to force Leche Industrializada CONASUPO (LICONSA) to source product, particularly NFDM, internationally. Mexican exports of dairy products have increased by an impressive 122 percent over the past five years, from \$97 million in 2003 to \$216 million in 2007. Most of this growth is being led by exports of Mexican cheeses, as well as concentrated dairy products.

Data included in this report is not official USDA data. Official USDA data is available at: <http://www.fas.usda.gov/psd>

SECTION II. STATISTICAL TABLES

PSD Table									
Country	Mexico								
Commodity	Dairy, Milk, Fluid								
	2006 Revised			2007 Estimate			2008 Forecast		
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
Market Year Begin	01/2006			01/2007			01/2008		
Cows In Milk	6,875	6,875	6,875	6,885	6,885	6,885	6,887	6,887	6,887
Cows Milk Production	10,051	10,051	10,051	10,100	10,100	10,290	10,185	10,185	10,300
Other Milk Production	163	163	163	165	165	168	168	168	168
Total Production	10,214	10,214	10,214	10,265	10,265	10,290	10,353	10,353	10,468
Other Imports	43	43	43	50	50	93	50	50	96
Total Imports	43	43	43	50	50	93	50	50	96
Total Supply	10,257	10,257	10,257	10,315	10,315	10,551	10,403	10,403	10,564
Other Exports	0	0	0	0	0	0	0	0	0
Total Exports	0	0	0	0	0	0	0	0	0
Fluid Use Dom. Consum.	4,305	4,305	4,305	4,275	4,344	4,431	4,253	4,350	4,437
Factory Use Consum.	5,952	5,952	5,952	6,040	5,971	6,120	6,150	6,053	6,127
Feed Use Dom. Consum.	0	0	0	0	0	0	0	0	0
Total Dom. Consumption	10,257	10,257	10,257	10,315	10,315	10,551	10,403	10,403	10,564
Total Distribution	10,257	10,257	10,257	10,315	10,315	10,551	10,403	10,403	10,564

PSD Table									
Country	Mexico								
Commodity	Dairy, Cheese								
	2006 Revised			2007 Estimate			2008 Forecast		
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
Market Year Begin	01/2006			01/2007			01/2008		
Beginning Stocks	0	0	0	0	0	0	0	0	0
Production	145	145	145	147	147	154	150	150	160
Other Imports	86	86	86	88	88	90	90	90	93
Total Imports	86	86	86	88	88	90	90	90	93
Total Supply	231	231	231	235	235	244	240	240	253
Other Exports	2	2	2	2	2	2	2	2	2
Total Exports	2	2	2	2	2	2	2	2	2
Human Dom. Consum.	229	229	229	233	233	242	238	238	251
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Consum.	229	229	229	233	233	242	238	238	251
Total Use	231	231	231	235	235	244	240	240	253
Ending Stocks	0	0	0	0	0	0	0	0	0
Total Distribution	231	231	231	235	235	244	240	240	253

PSD Table									
Country	Mexico								
Commodity	Dairy, Butter								
	2006 Revised			2007 Estimate			2008 Forecast		
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
Market Year Begin	01/2006			01/2007			01/2008		
Beginning Stocks	0	0	0	0	0	0	0	0	0
Production	109	109	114	121	121	126	130	123	130
Other Imports	49	49	45	50	50	53	50	50	62
Total Imports	49	49	45	50	50	53	50	50	62
Total Supply	158	158	159	171	171	179	180	173	192
Other Exports	0	0	0	0	0	0	0	0	0
Total Exports	0	0	0	0	0	0	0	0	0
Domestic Consumption	158	158	159	171	171	179	180	173	192
Total Use	158	158	159	171	171	179	180	173	192
Ending Stocks	0	0	0	0	0	0	0	0	0
Total Distribution	158	158	159	171	171	179	180	173	192

PSD Table									
Country	Mexico								
Commodity	Dairy, Milk, Nonfat Dry								
	2006 Revised			2007 Estimate			2008 Forecast		
	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New	USDA Official	Post Estimate	Post Estimate New
Market Year Begin	01/2006			01/2007			01/2008		
Beginning Stocks	20	20	20	20	20	20	20	20	20
Production	183	183	183	190	190	202	200	195	222
Other Imports	111	111	113	120	110	122	135	135	140
Total Imports	111	111	113	120	110	122	135	135	140
Total Supply	314	314	316	330	320	344	355	350	382
Other Exports	0	0	0	0	0	0	0	0	0
Total Exports	0	0	0	0	0	0	0	0	0
Human Dom. Consum.	294	294	296	310	300	324	335	330	362
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Consum.	294	294	296	310	300	324	335	330	362
Total Use	294	294	296	310	300	324	335	330	362
Ending Stocks	20	20	20	20	20	20	20	20	20
Total Distribution	314	314	316	330	320	344	355	350	382

NOTE: The above production figures include both WMP and NFDM as production figures for these two products are not regularly separated or registered separately. Industry sources believe Mexico's production of WMP is around 80 percent of total production.

PRODUCTION OF FLUID MILK BY STATE
(1000 LITERS)

STATES	2006	2007	2008*	% Change 07/08
AGUASCALIENTES	388,373	336,305	380,117	13.02
BAJA CALIFORNIA	171,569	203,960	201,948	(0.99)
BAJA CALIFORNIA SUR	44,625	43,150	43,659	1.17
CAMPECHE	33,633	35,517	37,284	4.97
COAHUILA	1,246,739	1,318,305	1,335,537	1.30
COLIMA	39,037	37,062	36,537	(1.41)
CHIAPAS	334,629	353,085	356,618	1.00
CHIHUAHUA	816,551	817,904	853,962	4.40
MEXICO CITY	13,142	9,779	13,880	41.93
DURANGO	1,013,417	1,013,010	1,038,714	2.53
GUANAJUATO	665,187	674,660	670,025	(0.68)
GUERRERO	81,521	76,437	78,974	3.31
HIDALGO	445,464	460,773	468,641	1.70
JALISCO	1,679,842	1,793,579	1,809,681	0.89
MEXICO	463,777	469,006	454,254	(3.14)
MICHOACAN	325,795	328,204	331,960	1.14
MORELOS	18,724	21,043	18,718	(11.04)
NAYARIT	64,761	64,384	66,539	3.34
NUEVO LEON	39,370	41,432	40,142	(3.11)
OAXACA	140,720	142,651	145,218	1.79
PUEBLA	365,213	369,573	391,442	5.91
QUERETARO	198,488	200,835	200,046	(0.39)
QUINTANA ROO	5,559	5,642	5,809	2.95
SAN LUIS POTOSI	149,638	139,551	146,040	4.64
SINALOA	80,990	89,688	101,827	13.53
SONORA	140,726	137,911	136,117	(1.30)
TABASCO	118,405	110,164	117,477	6.63
TAMAULIPAS	30,908	29,224	30,327	3.77
TLAXCALA	99,158	111,425	117,214	5.19
VERACRUZ	670,035	686,605	699,932	1.94
YUCATAN	6,768	5,557	5,798	4.44
ZACATECAS	163,100	163,667	164,560	0.54
TOTAL	10,050,721	10,290,086	10,498,996	2.03

SOURCE: Agriculture Secretariat (SAGARPA)

* SAGARPA's Revised Forecast figures for 2008

SECTION III. NARRATIVE ON SUPPLY, DEMAND, POLICY & MARKETING**Fluid Milk**

Fluid milk production for CY 2008 (Jan-Dec) is forecast to remain even with CY 2007 production at 10.46 MMT. This stalled production growth is largely the result of the fact that producers are paying significantly higher input costs, yet raw milk purchasing prices have not kept pace. Furthermore, because of favorable prices, and because of infrastructure constraints, fluid milk substitutes, such as NFDM, are becoming more competitive. The fluid milk production estimate for CY 2007 has been revised higher in this report reflecting greater productivity resulting from technological improvements and better herd management practices during the hot summer months. Factors such as poor sanitation and genetics, inefficient cold storage, poor refrigeration, and a lack of infrastructure, particularly in smaller and dual-purpose cattle operations, are starting to limit production gains in Mexico, particularly among smaller producers. In addition, small and medium sized dairies continue to be forced out of business due to high production costs and low productivity, particularly in the face of competition from larger, more sophisticated domestic producers. Relatively low domestic raw milk prices and lack of affordable financing for capital improvements have discouraged small and medium-sized dairy farms from expanding, especially in central and southern Mexico.

Private sector producer milk prices were on average about 30 percent higher in CY 2007, compared to CY 2006. This higher price paid to producers was the result of growing demand from Mexico's processing industry, as well as higher input costs facing dairy farmers. Producer milk prices in CY 2008 are expected to approximate higher U.S. prices. In CY 2007 LICONSA, the parastatal enterprise which provides milk to low income consumers, bought 382.5 liters of fluid milk on the domestic market at an average price of \$4.27 per liter. In CY 2008 LICONSA started buying milk from producers at \$4.40 per liter, and in February the company increased their purchase price by 6.8% to \$4.70 per liter, a price which will likely remain in effect for the remainder of the year. Thus far this year, LICONSA has purchased 80% more milk from domestic producers compared to the same time period in 2007.

Fluid milk consumption is forecast to remain stable in 2008 at roughly 10.5 MMT. The total consumption estimate for CY 2007 has been revised higher reflecting greater purchasing power among middle and lower income consumers, and significant growth in the processing industry. CY 2006 figures reflect official data.

Consumer prices in Mexico are currently averaging 9.60 per liter for pasteurized milk (U.S. \$0.93) and 10.42 per liter of UHT milk (U.S. \$1.01), 9 percent and 8 percent higher than CY 2007, respectively. LICONSA will distribute 1.12 billion liters of milk this year. Of this amount 74 percent is fluid milk, and 26 percent is milk powder. From this total, LICONSA allocates 84 percent, 940,000 liters, to be sold at the preferential price of 4.00 pesos per liter to qualifying persons. Although LICONSA has increased utilization of domestic fluid milk, its social programs continue to rely on imported NFDM. In CY 2007, LICONSA is estimated to have used 382.5 million liters of domestically produced raw fluid milk. This represents about 31 percent of LICONSA's total milk usage, up significantly over CY 2006 domestic purchasing rates, which constituted only 8 percent of LICONSA's total milk usage. Consumption of fresh fluid milk continues to be hampered by problems with sanitation, transportation, and processing capacity, but supplies and quality are improving.

According to government estimates, approximately 25 percent of milk in Mexico is consumed raw, and 25 percent is consumed through the government's social programs. The first case represents a potential health problem, and the second case a significant

government subsidy to consumers, which discourages domestic milk producers. The consumption of pasteurized milk and dairy products represent 50 percent of total consumption, which is expected to increase as incomes rise.

Fluid milk imports for CY 2008 are forecast to increase slightly. As in previous years, most fluid milk imports will go to border cities in northern Mexico as opportunities for sales beyond the border are limited by transportation costs. The estimate for CY 2007 imports have been revised sharply higher, reflecting tighter supplies of fluid milk in the border region due to LICONSA mandates to source more fluid milk domestically. Imports for CY 2006 reflect official data.

CHEESE

Cheese production for CY 2008 is forecast to increase by less than 4 percent from the previous year's revised estimate. Production by commercial cheese processors, particularly those using imported NFDM, is increasing in order to meet the growth in consumer demand as Mexicans increase their consumption of processed products containing cheese. Output for CY 2007 reflects official data. According to industry sources, cheese manufacturers who buy from independent milk producers are paying between \$3.80 pesos to \$4.20 pesos per liter.

Cheese consumption during CY 2008 is forecast to increase compared to the previous estimates as a result of growing demand among middle-income consumers.

Cheese imports are expected to be slightly higher in CY 2008 as consumers continue to develop preferences for non-Mexican cheeses. Mexico's growing economy is expected to continue to foster consumer demand for imported cheeses. Imports for CY 2006 reflect official data. Production, supply and demand figures for CY 2007 have been changed slightly, reflecting higher than anticipated production figures.

BUTTER

All Mexican statistics for butter and butterfat production are combined. Butter (and butterfat) production for CY 2008 is forecast to remain even with the previous year's revised estimate. The CY 2007 butter production estimate was revised upward due to greater demand from domestic baking and confectionary industries. Production for CY 2006 reflects official data.

Combined butter and butterfat consumption is estimated higher than the previous forecast for CY 2008 due to the expected higher demand from the baking and confectionary industry. The estimate for CY 2007 was also revised upward reflecting increased usage of butterfat in the baking, confectionary and food processors industry. Consumption for CY 2006 reflects official data.

Consistent with past years, no stocks are estimated due to the lack of refrigerated storage space among producers and end users. Users such as bakeries and food processors do not keep large stocks of butter.

The CY 2008 import figure has been revised upward from the previous estimate due to the gap created by stagnant domestic production and growing demand. The import estimate for CY 2007 was also been revised upward, due to the increase in domestic demand. Imports for CY 2006 reflect official data.

NON-FAT DRY MILK (NFDM)

Official sources combine production figures of NFDM and WMP, thus it is difficult to analyze production and consumption trends for these two products separately. As a category, domestic production of milk powder, whether non-fat or whole milk, is expected to increase by nearly 10 percent in CY 2008. This increase is likely driven by LICONSA mandates to source more dairy product domestically, and cold chain and infrastructure constraints which make dried milk a more convenient option for distributors. The output estimate for CY 2007 has been revised higher. The CY 2006 production estimate reflects official data. Overall production capacity is limited, which is why imports are required to meet demand. However, Mexico's milk powder producers are starting to make investments in production capacity in order to meet market conditions.

Consumption for CY 2008 is forecast to increase by nearly 12 percent over the previous year's revised estimate. The CY 2007 consumption figure reflects official data.

The majority of NFDM that is imported or produced domestically is used for further processing. LICONSA is the main holder of milk powder stocks. In recent years, due to pressure from producers, LICONSA had tried to maintain larger stock levels to avoid imports during the early part of the calendar year when domestic milk production is highest. Thus far in 2008 LICONSA has purchased over 90,000 MT of NFDM.

Mexico's imports of NFDM are expected to increase in 2008 due to the elimination of the NAFTA TRQ and lower prices. NFDM prices are expected to average USD \$1.360 to USD \$1.400 per pound in 2008, about 30 percent lower than 2007 prices. CY 2008 imports are forecast at 140 MMT, notably higher than the 122 MMT imported in 2007. The U.S. holds 75% of the NFDM import market in Mexico, followed by New Zealand with 10%, the U.K. with 5%, and Canada with 2%.

WHOLE MILK POWDER (WMP)

As previously stated, production data for WMP is not available, as official sources combine production figures of NFDM and WMP. Selected processors, including dairy cooperatives, are attempting to increase WMP production to absorb seasonal oversupplies of fluid milk. However, due to limited processing facilities, Mexico will still have to complement domestic production with imports.

POLICY

All U.S. exports of dairy products to Mexico can enter duty-free. The TRQ which had regulated the U.S.-Mexico NFDM trade during the 15 year NAFTA phase-in was finally eliminated on January 1, 2008. Preliminary export data indicates that the elimination of this TRQ, coupled with favorable prices, will result in significantly higher NFDM exports to Mexico this year. In the first three months of 2008 U.S. exports of NFDM to Mexico are already outpacing the same period in 2007 by 113%.

In March of 2008 the U.S. and Mexico agreed upon a protocol for U.S. exports of breeding cattle to Mexico. This is significant to the Mexican dairy industry, as it will allow them more flexibility in sourcing genetic stock from the U.S. The previous dairy and breeder cattle protocol stipulated that animals be no older than 24 months, whereas the new protocol

eliminates an age limit, in accordance with OIE recommendations for trade of ruminant animals among controlled risk countries.

The main objective of the Mexican government's dairy policies is to encourage milk producers to improve efficiency and productivity levels. The primary dairy program is Fondo Nacional del Programa Nacional de Apoyo para las Empresas de Solidaridad (FONAES), which is aimed at improving genetics through artificial insemination and/or transplanting embryos. Larger producers have benefited the most from this and other smaller programs, at the expense of smaller, less efficient producers. Mexico's larger producers have made production gains in recent years, primarily through improved genetics and use of production technologies such as water sprayers to keep animals cool.

LICONSA purchases fluid milk from smaller producers at prices mandated by Congress. In CY 2007, LICONSA purchased approximately 382.5 million liters of milk domestically. Mexico's Federal Income Law (Ley de Ingresos de la Federacion para el Ejercicio) authorizes Congress to mandate the price LICONSA pays domestic producers for fluid milk in a given fiscal year. This price usually represents a maximum, and LICONSA may pay less depending on the quality of the milk and distance from the collection center. In 2007, prices paid by LICONSA, as mandated by Congress, averaged 4.27 pesos per liter (U.S. \$.42). As stated earlier, LICONSA will be paying \$4.7 pesos per liter for the majority of 2008. Private dairy processors paid \$4.8 (U.S. \$.46) to \$5.2 pesos (U.S. \$.50) per liter in 2007, and will likely pay more this year.

MARKETING

The cooperator group that represents the U.S. dairy industry in foreign markets is the U.S. Dairy Export Council (USDEC). The council's staff in Mexico provides information on all aspects of U.S. dairy product trade and use, including market intelligence on trade policy issues, organizing informational seminars for the Mexican trade, and developing promotion and sales opportunities for U.S. dairy products in the Mexican market. USDEC also organizes buying missions for potential Mexican importers/distributors to visit U.S. dairy processing plants so they can meet U.S. suppliers. Mexico is expected to continue as a significant importer of dairy products to augment domestic production. While imports are likely to consist primarily of bulk products such as NFDM, higher value products such as specialty cheeses and ice creams are also likely to find a home in Mexico's growing consumer class as tastes, preferences, and shopping habits increasingly mirror those of the United States and Europe.

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